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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, MARCH 25, 2003

APPLICATION OF

THE POTOMAC EDISON COMPANY  
D/B/A ALLEGHENY POWER

CASE NO. PUE-2002-00322

To revise its cogeneration  
tariff pursuant to PURPA  
§ 210

FINAL ORDER

On June 12, 2002, the Potomac Edison Company d/b/a Allegheny Power ("AP" or "Company") filed with the State Corporation Commission ("Commission") an application, written testimony and exhibits to support its proposal for the year 2002 to change its cogeneration and small power production rates under its Schedule CO-G. Schedule CO-G establishes payments, based on the Company's avoided costs for energy and capacity, for purchases from cogenerators and small power producers with a design capacity of 100 kW or less. The Company proposes to revise its Schedule CO-G to replace its currently approved administratively-determined avoided cost pricing methodology with a market-based pricing methodology for determining the Company's payments to qualifying generating facilities for electricity purchased under § 210 of the Public Utility Regulatory Policies Act of 1978 ("PURPA").

By order issued August 15, 2002 ("Order"), the Commission established this proceeding, and set a procedural schedule whereby it provided interested persons an opportunity to file comments and/or requests for hearing on the application on or before September 17, 2002, and directed the Commission Staff to file a report or testimony on or before October 18, 2002. No

comments or requests for hearing were filed. Pursuant to the Order, the Staff filed the testimony of Jarilaos Stavrou of the Commission's Division of Economics and Finance on October 18, 2002. On February 6, 2003, Hearing Examiner Howard P. Anderson, Jr. issued his report in this proceeding.

The Company proposes to change the methodology it presently uses to calculate payments to its QFs under Schedule CO-G, eliminate capacity payments, revise contract duration terms, and revise certain customer and metering charges. At the present, the Company employs the Differential Revenue Requirements ("DRR") methodology to forecast its avoided costs. The Company has restructured and no longer owns generating facilities. By Order dated July 11, 2000, the Commission approved Potomac Edison's plan to transfer its generating units to an affiliate in Application of The Potomac Edison Company d/b/a Allegheny Power, For Approval of a Functional Separation Plan, Case No. PUE-2000-00280, 2000 S.C.C. Ann. Rep. 530.

The new Schedule CO-G proposes to utilize market-based pricing to determine the Company's avoided costs, rather than the traditional DRR methodology. The Company proposes an avoided cost energy payment to cogenerators and small power producers based on market-determined firm energy prices from the PJM Interconnection wholesale electric market region. The Company states that it will purchase from the market the energy and capacity it requires to supply its customers, and therefore, the Company's future avoided costs will be determined by the cost of its avoided market purchases of power. AP proposes to revise and update its cogeneration rates annually hereafter based on current projections of forward energy prices. The Company also proposes to eliminate a separate capacity payment component. AP states that QFs that qualify under Schedule CO-G have too small a design capacity to have significant value in

the PJM capacity market and further that PJM prices used to estimate its avoided costs already contain an intrinsic capacity payment component.

This proceeding concerns wholesale payments AP will make to cogeneration facilities and small power producers under PURPA. Under PURPA, this Commission, as well as other states commissions, are granted the authority to establish utility payments to PURPA-qualified cogeneration facilities and small power producers ("qualifying facilities" or "QFs") on the basis of costs avoided by AP by obtaining power from these QFs, rather than acquiring such power from other sources.

AP states in its application that Virginia's energy markets have gone through significant changes since the Commission last reviewed AP's cogeneration rates in Case No. PUE-1998-00055.<sup>1</sup> The Company emphasizes that it no longer owns generating facilities, nor does it plan to build or purchase new generation in the future, but purchases electric generation supply under contract to meet its default service obligations. Currently there are no QFs or pending applications from QFs, in the Company's Virginia jurisdictional service territory, to which AP's Schedule CO-G applies.

Staff's testimony states given that the Company expects to purchase energy for its regulated customers in the PJM market, and that its forecasting methodology will be refined as more data become available, that the methodology employed by the Company in this proceeding to forecast firm energy prices was acceptable for the purposes of the Company's instant application. The Staff recommends that as the Company refines its forecasting methodology, it should obtain market price data from the sources listed in the Commission's Final Order in Case No. PUE-2001-00306, and as modified by its Final Order of October 11, 2002, and perform

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<sup>1</sup> Application of The Potomac Edison Company, To revise its cogeneration tariff pursuant to PURPA § 210, 1998 S.C.C. Ann. Rep. 394.

calculations consistent with the calculations set forth in the Final Order of October 11, 2002.

Staff further recommends that when appropriate, the market price information should be adjusted to reflect the fact that the electrical production will take place in the Company's Virginia service territory rather than at the price points reflected in the market data.

The Staff also found that the avoided energy cost estimates proposed by the Company to be used in setting the cogeneration tariff rates were reasonable. Staff also supports the Company's proposal to offer contracts with a maximum duration of three years and update avoided cost rates annually using market prices, because it will allow the Company more flexibility in adapting its costs to market conditions. The Staff also accepts the Company's proposed updates to metering and customer charges, including the proposal to eliminate simple time-of-use meters. Staff believes these charges are cost-based.

In his Report the Hearing Examiner found based on the evidence that the Company's proposed methodology was appropriate for this case, and its proposed avoided energy costs and other proposed changes were reasonable. The Hearing Examiner further adopted the Staff's recommendations relative to the Company updating its pricing methodology and Schedule CO-G.

NOW THE COMMISSION, in consideration of this matter, finds that the findings and recommendations included in Hearing Examiner Howard P. Anderson's Report dated February 6, 2003, should be adopted in full.

Accordingly, IT IS ORDERED THAT:

- (1) The findings and recommendations set forth in the Hearing Examiner's February 6, 2003, Report are hereby adopted and approved;
- (2) This matter is dismissed from the Commission's docket of active cases.